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PRE-UNCTAD X SEMINAR ON MAKING FDI WORK FOR SUSTAINABLE DEVELOPMENT

Geneva, 15 November 1999

Overview and summary report

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Overview

1. On 15 November 1999, UNCTAD convened a seminar entitled, *"Making FDI Work for Sustainable Development"*. The theme of the seminar is a tribute to the growing relevance of environmental concerns to foreign direct investment (FDI) and the "paradigm shift" in the practices of transnational corporations (TNCs) from «doing no harm», i.e. environmental protection, to making a positive contribution towards sustainable development.

2. The meeting, organized jointly by the Division on International Trade in Goods and Services, and Commodities (DITC) and the Division on Investment, Technology and Enterprise Development (DITE), was one in a series of events leading up to UNCTAD X in Bangkok in February 2000.

3. The present report is being provided as part of the substantive preparations for UNCTAD X. It is intended to enable the Preparatory Committee of the Whole for UNCTAD X to recommend ways in which the Conference can address the various aspects of interface between FDI, environment and development.

4. Some 100 government officials, business people, experts and NGO representatives attended the seminar and explored ways to draw on the managerial and technological benefits of FDI and to create «green» business networks.

5. The preliminary findings of two current UNCTAD projects on the environmental practices of TNCs in host developing countries were presented. A project on cross-border environmental management practices in TNCs is being carried out by the Copenhagen Business School, in cooperation with UNCTAD's DITE and with financial support from the Danish International Development Agency (DANIDA). As part of this project, a series of case studies are being conducted on environmental practices of TNCs in China, India and Malaysia. The project also provides unique data on environmental management practices in 154 TNCs in these countries.

6. A parallel project is being run by the Institute for Environmental Management and Business Administration at the European Business School in Oestrich Winkel, Germany, in cooperation with UNCTAD's DITC and with financial support from the German Federal Environmental Agency. The project, based on five company-level case studies in China, India and Malaysia, explores measures for promoting sustainable development through FDI and will help determine whether the transfer and diffusion of clean technologies through TNCs may support the efforts of developing countries in achieving the objectives of multilateral environmental agreements (MEAs).

7. Much of the discussion in the seminar revolved around two major trends that have been shaping environmental management practices of TNCs in the past decade: a movement towards greater transparency, and the reorganization of the value-added chain on an international scale. The general conclusion of the seminar is that TNCs have a large, but largely unexplored, potential to contribute to sustainable development.

8. Since TNCs are not homogeneous, and the situation with FDI differs from country to country and from sector to sector, the meeting discussed a wide range of issues. Some of the more important points highlighted at the meeting are as follows:

- There is no "critical mass" of empirical evidence on the environmental impact of FDI;

- Global environmental transparency, particularly environmental reporting by TNCs, is a cornerstone of sustainable FDI;

- "Home" country measures are important in terms of setting up incentives for the implementation of environmental management systems and transfer of environmentally sound technologies (ESTs).

- There is a need to strengthen the regulatory capacity of host countries and their ability to steer FDI in the right direction.

- Government procurement has an important role to play, especially when the Government is the major, or the only, customer of TNCs.

- Since environmental management systems and transfer of environmentally sound technologies are intensive in infrastructure and human resources, there is a need to increase the absorptive capacity of host countries through training and technical assistance.

- Pressure to conform to high environmental standards is being passed along a supplier chain down to the small and medium-sized enterprises (SMEs). Without assistance, SMEs risk exclusion.

- Corporate and social responsibility is an «entry point» for making FDI work for sustainable development. There is an encouraging trend towards the convergence of governmental, business and NGO perspectives on principles such as respect for economic practicalities and environmental limits, empowerment of people, and accessibility of environmentally sound technologies and products.

9. The meeting made the following suggestions on **future activities** to be carried out by UNCTAD, building on the ongoing work of DITC and DITE:

- Conducting *case studies at the company and industry* level with a view to promoting informed consensus - and decision-making. The geographical coverage of the studies may be expanded to include other countries and regions, e.g. Latin America and Africa;

- Promoting *global environmental transparency* by monitoring trends in cross-border environmental management, benchmarking TNCs, activities and establishing format, content or measurements for the environmental reporting of TNCs;

- Promoting *dialogue and consensus* among the various stakeholders;

- Providing *expert advice* to Governments on matters relating to environmental management systems and transfer of environmentally sound technologies; and

- Consolidating and disseminating *information* on initiatives taken by Governments and international organizations and best practices of TNCs in cross-border environmental management.

The summary report of the seminar follows.

Summary report

10. The issues on the agenda were discussed in three sessions. The first session considered the role of TNCs in promoting environmental management practices in host developing countries; the second session examined the actual and potential contribution of FDI to the transfer and diffusion of environmentally sound technologies; and the third session discussed the role of stakeholders in making FDI work for sustainable development.

11. **In session 1**, the participants familiarized themselves with the results of a survey, based on the sample of 154 TNC affiliates in China, India and Malaysia and company experiences. Some of the main findings of the survey follow.

- Since external certification concerned only management practices and did not set any requirements in terms of environmental performance, it is quite possible for a company to have a state - of-the-art environmental management system and still have a large environmental footprint.

- TNCs tended to manage their environmental responsibilities internationally through cross-border environmental management systems (EMS), which defined obligations, processes, standards and auditing and reporting procedures. It was through those systems that TNCs transferred EMS-related "know-how" to their foreign subsidiaries.

- High risks to reputations of TNCs required strict global standards and transparent reporting. TNCs were subject to great scrutiny by the public and NGOs and were therefore exposed to such risks. Those risks largely defined the environmental standards of TNCs, which generally tended to be stricter than the local requirements.

- TNCs were generally subject to more stringent enforcement of regulations than local companies, which had to do not only with the fact that they were foreign business entities, but also with the sheer size of TNCs, operations.

- Pressure to conform to high environmental standards was being passed along the supply chain down to the SMEs. Without assistance, SMEs could risk exclusion.

12. Most of the discussion that followed dealt with issues of environmental transparency and supply chain management. Transparency was considered crucial for environmental performance. As the main determinants of transparency, environmental reports of TNCs, internal and external, voluntary and mandatory, must provide a credible portrait of their global activities. Ideally, those reports should not include only information on the use of inputs (energy, water materials, etc.) and outputs (solid wastes, emissions, effluents, etc.), but also the strategy or programmes for managing activities with significant environmental impact. Publishing environmental reports for subsidiaries in the host countries could prompt other local companies to follow suit and thereby assist the diffusion of environmentally sound management practices.

13. Considerable progress in eco-efficiency could be achieved through supply chain management, making full use of the purchasing power of consumers, businesses and the public sector. Traditionally, management requirements along the supply chain were related to quality issues. A successful integration of environmental criteria into specifications for suppliers depended critically on whether that led to cost reduction or whether the market would honour the improved overall

environmental efficiency. Some TNCs had already started "greening" the supply chain. Spreading this practice would greatly improve the environmental effects of FDI.

14. Improving global environmental transparency and supply chain management required a considerable degree of cooperation between TNCs and their suppliers in the developing countries, including financial assistance, the transfer of know-how and the training of local personnel in the implementation of environmental management systems. They also required an inordinate amount of cooperation and coordination between the home and host countries, and competent steering by the international community.

15. Since the introduction of EMS was intensive in infrastructure and human resources, a number of suggestions were put forward regarding training and education, building institutional capacity and improving access to information.

16. **In Session 2,** the trade and environment debate had put a lot of emphasis on the need for the developing countries to have access to environmentally sound technologies. The secretariat had been dealing with this issue in the context of MEAs, the Rio Declaration and Agenda 21. More recently, that work had focused on the role of TNCs in facilitating access to ESTs through direct technology transfer to subsidiaries in host countries, as well as through diffusion, i e. spill over effects benefiting other local companies.

17. A number of issues relating to technology transfer were dealt with in a series of projects on trade and the environment. Those projects covered such issues as capacity-building, the role of the private sector in facilitating access to and transfer of environmentally sound technologies, meeting product requirements in export markets and the role of FDI and ESTs in this context, and the contribution of FDI to the development of tradable products based on traditional knowledge.

18. The meeting considered the interim results of the case studies of German companies operating in India, China and Malaysia. Bosch Siemens Hausgerate GmbH (BSH), Hoechst Marion Roussel AG (HMR), ADtranz AG, Asea Brown Boveri AG, and Burgmann GmbH were participating corporations, with the Centre for Environmentally Sound Technology Transfer (CESTT) in China, Administrative Staff College India (ASCI) and Centre for Environmental Technologies (CETEC) in Malaysia as partner institutes. The following learning points emerged from the preliminary findings of the studies.

- Market access and business opportunities were the main determinants of TNCs' behaviour. However, profits and environmental protection could be compatible through effective clean technology transfer.

- Because of high energy costs and often unreliable supplies, energy conservation was one of the main environmental parameters for TNCs operating in newly industrialized and developing countries. Therefore, transfer of energy-efficient technologies was especially important.

- Public procurement played an important role in improving technology transfer. By setting environmental requirements, public authorities could use their purchasing power to promote technology transfer. Moreover, they could assist in making it accessible for the local industry through licensing.

- Strategic alliances and joint ventures created the best conditions for the transfer of environmentally sound technologies, while backward and forward linkages between TNCs and local companies serve as a conduit for the spillover effects.

- Access to environmentally sound technologies was essential for the successful implementation of environmental management systems.

- From the host country perspective, technologies relating to the Montreal Protocol (refrigeration and aerosols) and the United Nations Framework Convention on Climate Change (energy-saving technologies, particularly in the coal sector) as well as biotechnology were considered particularly important.

- It was common for technology transfer opportunities to be prompted by the environmental standards adopted by TNCs' headquarters. However, empirical evidence suggested that it was the opposite trend – towards differentiation among local production sites – that seemed to be prevalent among TNCs.

- It was necessary to address the situation with small firms and to explore the ways to transfer environmentally sound technology to them.

19. The discussion that followed focused on success factors in the transfer of environmentally sound technologies, such as the shift from the "end-of-pipe" approaches to process modification, the development of innovative technologies to respond to the particular needs of developing countries, and technology diffusion allowing domestic suppliers and firms to benefit from technology flows.

20. The meeting noted that FDI had a traditional reliance on natural resource use and extraction, particularly mineral and fuel production. Although that balance had shifted in recent years, the poorest countries still received a disproportionately large amount of FDI their natural resource sector. Flows of natural resource-based commodities and investments were predicted to continue to rise faster than economic output. It was therefore critical to understand the environmental effects of FDI and identify appropriate responses.

21. A proactive interpretation of environmental and social responsibility by mining companies should go beyond their legal obligations to employees and shareholders to address not only the direct effects of their activities on the biophysical environment but also the indirect effects of those activities on the development rights of local communities affected by mineral development projects.

22. In general, technology transfer was not just about plant, equipment or consultancy services. It involved the sharing of knowledge, expertise and experience required to manage technical change, of both incremental and radical nature, and the development of human resources to implement organizational changes and improve overall production efficiency and environmental management throughout the plant and facility. It was important to realize that those real contributions of capacity did not have to have a detrimental effect on suppliers' strategic control of proprietary technology.

23. Globalization of production processes, regulatory, peer, supply chain and internal pressures, codes of conduct, action groups, financial considerations, environmental change – the relative weight of those factors in eco-efficient technology transfer differed from company to company and from sector to sector. However, the following conditions were common to most of the success stories:

- Technology suppliers sought rent and track records from the diffusion of clean technologies and environmental friendly reputations. Fast, efficient and clean application was considered a crucial marketing advantage.

- Technology suppliers set up "user clubs" supported by investment in technical support from innovators to capture ongoing benefits of user adaptation and improve further technology worldwide.

- Technology recipients were permitted to keep benefits accruing from modifications to strengthen their capacities and to promote more efficient and cleaner production.

- Supplier-recipient collaboration lasted longest typically within strategic alliances.

- "Win-win" scenarios existed, but were not automatic. They were created by the application of purposeful strategies in the context of corporate and social responsibility.

24. **In session 3**, the meeting considered the role of stakeholders and, more specifically, environmental activities of investment promotion agencies in home countries, with reference to the Industrialization Fund for Developing Countries in Denmark; the role of civil society and public-private partnership; and actions at the international level.

25. Programmes to promote sustainable FDI were run mainly from OECD countries. The programmes ranged in scope and focus and were not always coordinated. Some were concerned with stipulating environmental and social conditions for supporting major investment projects in the developing world, prior to and throughout the project cycle, on the lines of the World Bank Guidelines. Others explored opportunities to achieve development objectives and, at the same time, promote local expertise in "clean" technologies. A number of agencies offered a mixture of both, and placed their officers in the host countries to facilitate and support partnerships between firms in the home and host countries.

26. A relatively new development was that smaller, specialized OECD-based firms played a role in these partnerships. A number of programmes were aspirational and voluntary in nature and developed voluntary codes of conduct for their businesses operating overseas.

27. Since most answers to environmental problems -- financial, technological and managerial - lay with the private sector, the traditional focus on the inter-governmental process was no longer sufficient. There was a clear need for constructive engagement of the private sector in order to make sure that FDI did not overwhelm the regulatory capacity of host Governments, and that the short-term environmental impact did not outweigh long-term positive effects.

28. While the principle of subsidiarity in dealing with environmental problems pointed in the right direction, putting this principle into practice was a long-term task. A participatory and transparent approach, ensuring that everyone affected by FDI was equally represented, was important. Also important was cross-sectoral engagement in order to avoid a situation where environmental problems, instead of being resolved, were merely transferred from one sector to another.

29. Some participants noted a trend towards the convergence of governmental, business and NGO perspectives on principles such as respect for economic practicalities and environmental limits, empowerment of people, and accessibility of environmentally sound technologies and products. One case in point was the shift to production of CFC-free refrigerators, when Greenpeace was acting not

only as a pressure group but also as a catalyst for innovation and as a public relations or marketing agency for the new technology.

30. The meeting felt that much more coordination and cooperation, between developed and developing countries was required in matters relating to the multilateral rules on FDI so as to prevent harmful forms of competition and to promote the "right kind" of FDI.

31. Given the importance of global environmental transparency, the meeting revisited this issue in the context of what UNCTAD, the United Nations Environment Programme and other organizations had been doing to make environmental reports useful to stakeholders, including the financial community.

32. The absence of an accepted definition of environmental costs was another problem. In order to capture the essence of environmental liabilities, there was a need to go beyond the category of legal obligations to include constructive and "equitable" obligations. A constructive obligation arose when a firm publicly stated its environmental policy. Meeting "equitable" obligations required that TNCs should maintain the same standards of reporting on environmental liabilities arising from legal obligations in developed countries as on similar liabilities when they arose in developing countries where there was no legislation.

33. Another area requiring attention was environmental cost accounting. Most cost (management) accounting systems accounted for costs by the firms usually borne, not the external costs, but it was important to get a good system in place as more and more of those external costs became externalized through growing obligations. It was difficult to identify best practices, but that might be an area for useful prototype work in the future.

The programme, the opening speech of Rubens Ricupero, Secretary-General of UNCTAD, and substantive documentation on the meeting can be downloaded from the UNCTAD website.